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No. 82-688

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1982

CAPITOL INDUSTRIES-EMI, INC.,
Petitioner,

VS.

WILLIAM BENNETT, and ERNEST J. DRONENBURG, JR., Successor; KENNETH CORY; RICHARD SILBERMAN, and MARY ANN GRAVES, Successor; and MARTIN HUFF and GERALD H. GOLDBERG, Successor,
Respondents.

On Petition for Writ of Certiorari To the United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether 28 United States Code section 1341, in any event, bars this action.

2. Whether the Eleventh Amendment to the United States Constitution bars this action.

3. Whether the anti-injunction provisions of the California Constitution and statutes bar this action.

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BRIEF FOR RESPONDENTS IN OPPOSITION

I

JURISDICTION

The technical jurisdictional requirements appear to be set forth adequately in the petition. It should be observed that petitioner's contentions were rejected by the United States Court of Appeals, Ninth Circuit, based upon and in conformity with the pertinent decisions of this Court and the California courts. Moreover, petitioner's petition represents nothing more than a blatant attempt by petitioner, a corporation doing business in California, to circumvent well-established procedures for contesting taxes assessed against it by the Franchise Tax Board (hereafter "FTB") of the State of California.

II

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

1. Eleventh Amendment to the United States Constitution.

2. Section 1341, title 18, United States Code.

3. California Constitution, article XIII, section 32.

4. California Revenue and Taxation Code sections 26101, 25101, 25128 and 25137.

III

STATEMENT OF THE CASE

Prefatory Statement

As petitioner had done previously in its petition for certiorari while this case was still pending in the Court of Appeals, Ninth Circuit,[1] it has egregiously misstated a cru-

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[1]Filed on December 18, 1981, in this Court under No. 81-1177.

cial fact in the opening statement of its "Statement of the Case," when it states that defendant tax officials seek to assess a tax against petitioner on a portion of the income of its parent and 71 non-United States subsidiaries. (Petn. for Cert., p. 3.) First, the proposed assessment was made by the FTB of the State of California and not by any of the named defendants. Second, the proposed assessment was an assessment against petitioner based on the unitary method of taxation and *not an assessment on a portion of the income of petitioner's parent or related corporations.*

In addition, petitioner has failed to mention or discuss the cases of *Fair Assessment In Real Estate Association, Inc. v. McNary* (1981) ..... U.S. ....., 70 L.Ed.2d 271, and *California et al. v. Grace Brethren Church* (1982) ..... U.S. ....., 73 L.Ed.2d 93. Both of these cases expressly sustained the long-established principle of federal-state relationship that the federal judiciary should not interfere in state tax matters.

The above-mentioned misstatement of fact and omission of two recent landmark cases of this Court vividly demonstrate the total lack of merit in petitioner's petition.

1. Statement of the Case

In this matter, on August 15, 1979, petitioner Capitol Industries-EMI, Inc. (hereafter "Capitol") filed an action for injunctive and declaratory relief against the named defendants to prevent the FTB from assessing additional taxes against Capitol on the unitary tax method. The trial court granted summary judgment to the respondents on the grounds that Capitol had a "plain, speedy, and efficient state remedy" in the state court.

Capitol then appealed the decision to the Court of Appeals, Ninth Circuit, which also held that Capitol had a plain, speedy and efficient remedy before the state administrative agency and court, and remanded the case for dismissal.

2. Facts of the Case

The only facts which are essential to resolve this appeal are as follows:

a. Capitol is a United States corporation doing extensive business in California and elsewhere.

b. EMI Limited (hereafter "EMI") is a United Kingdom corporation, which holds over 70 percent of the outstanding shares of Capitol.

c. Capitol is a California taxpayer.

d. FTB has proposed to assess additional taxes against Capitol for the years 1968 through 1974 on the unitary method.

e. Under the unitary method, which has been upheld time and time again by the California and United States Supreme Courts, the incomes of all companies which are determined to be engaged in a unitary business are combined and apportioned according to a formula.[2] *(Butler Bros.*

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[2]California Revenue and Taxation Code section 25101 provides in part:

> "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of article 2 (commencing with section 25120 of this chapter)...."

v. McColgan (1942) 315 U.S. 501, affirming 17 Cal.2d 664; *Edison California Stores, Inc. v. McColgan* (1947) 30 Cal. 2d 472; *Superior Oil Co. v. Franchise Tax Board* (1963) 60 Cal.2d 406 and *Chase Brass & Copper Co. v. Franchise Tax Board* (1970) 10 Cal.App.3d 496.)

f. Under the California method, the following formula is generally used to compute an individual taxpayer's California source income:

Taxpayer's property in California / Combined group's total property everywhere	= %
Taxpayer's payroll in California / Combined group's total payroll everywhere	= %
Taxpayer's sales in California / Combined group's total sales everywhere	= %
Total of Three Percentages	= %

Total of Three Percentage ÷ 3 = Average Percentage

Average Percentage × Total Combined Income = Taxpayer's California Source Income[3]

g. In this case, FTB included the combined incomes of Capitol and EMI in determining Capitol's California source income. The resulting tax deficiency was then imposed against Capitol. (Par. V of Capitol's Complaint.)

h. Capitol filed a protest with FTB with respect to the proposed additional assessment. Thereafter the FTB made an adjustment and issued a revised assessment against Capitol.

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[3]California Revenue and Taxation Code section 25128 provides:

"All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three."

California Revenue and Taxation Code sections 25129 through 25136 define and provide for the computation of the property, payroll and sales factors.

i. Capitol filed a petition with the FTB under California Revenue and Taxation Code section 25137[4] for authorization to use another method of reporting the tax. The FTB denied Capitol's petition for relief under Revenue and Taxation Code section 25137 on October 1, 1981.

j. Capitol then filed an appeal with the California State Board of Equalization, where the matter is presently pending.

k. Capitol has not sought any relief before the California state courts.

l. Capitol has not paid the tax because its state administrative appeal is still pending.

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[4]Revenue and Taxation Code section 25137 provides as follows:

"If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

"a. Separate accounting;

"b. The exclusion of any one or more of the factors;

"c. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

"d. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

ARGUMENT

I

THE COURT PROPERLY ORDERED DISMISSAL OF THE ACTION BECAUSE THE COURT LACKED JURISDICTION

A. 28 United States Code Section 1341 Bars the Federal District Courts from Hearing a Case Such as the Instant One

The historic rule that the federal courts will not interfere with the internal fiscal operations of the states has been codified in 28 United States Code section 1341:

> "The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that 28 United States Code section 1341 is an explicit congressional limitation on the jurisdiction of the federal courts in cases which would enjoin, suspend or restrain state tax levy, assessment or collection. (*Randall v. Franchise Tax Board of the State of California* (9th Cir. 1971) 453 F.2d 381, 382; *Bland v. McHann* (5th Cir. 1972) 463 F.2d 21, 24, cert. denied, (1973) 410 U.S. 966.) Furthermore, neither the judicial decisions nor section 1341 require that the state remedy be the best remedy available or even equal to or better than the remedy which might be available in the federal courts. *(Id.)*

During the past term, this Court has unequivocally reaffirmed this principle in two different cases so as to remove any doubts as to its breadth and scope. Apparently petitioner has not read those decisions as evidenced by the absence of any reference to them in its instant petition.

The first case of note is *Fair Assessment In Real Estate v. McNary, supra,* ..... U.S. ....., 70 L.Ed.2d 271, where this Court held that under the principle of comity taxpayers cannot assert section 1983 actions against the validity of state tax systems in federal courts prior to the exhaustion of state remedies.

In *Fair Assessment,* plaintiff property owners brought suit against various county officials for damages under the Civil Rights Act. (42 U.S.C. § 1983.) In their complaint, the plaintiffs alleged principally that:

> (1) Properties with new improvements were assessed at 33½ percent of current market value while those without improvements were assessed at 22 percent of current market value; and
>
> (2) Property owners who successfully challenged assessments against their properties were assessed at a higher rate the following year.

This Court sustained the trial court's decision barring plaintiffs' action on the grounds of comity and the proscriptions of the Anti-Injunction Act. In its decision this Court reviewed the legislative history of the Anti-Injunction Act and the long-established principle of comity in the federal courts and said:

> "This case is therefore controlled by principles articulated even before the enactment of § 1983 and followed in later decisions such as *Matthews* and *Great Lakes.* The recovery of damages under the Civil Rights Act first requires a 'declaration' or determination of the unconstitutionality of a state tax scheme that would halt its operation. And damage actions, no less than actions for an injunction, would hale state officers into federal court every time a taxpayer alleged the requisites of a § 1983 claim. We consider such interference to be contrary to 'the scrupulous regard for the right-

> ful independence of state governments which should at all times actuate the federal courts.' Matthews, 284 U.S. at 525." (*Id.*, at p. 283.)

This Court then concluded that plaintiffs first must exhaust all state remedies, including those pertaining to section 1983 if a state has such a remedy.

In short, this Court again held that taxpayers must exhaust all state remedies before going to the federal courts.

The second important decision reaffirming the integrity of the Anti-Injunction Act is *California et al. v. Grace Brethren Church, et al., supra,* ..... U.S. ....., 73 L.Ed.2d 93. In that case, a Federal District Court in California held that Federal Unemployment Tax Act section 3309(b)(1) (26 U.S.C. § 3309(b)(1)) and California Unemployment Insurance Code section 634.5(a) were unconstitutional as interpreted and applied. The District Court had concluded that the application of said statutes results in excessive entanglement of the state with religion in the benefit eligibility determination process with the respect to employees of independent religious schools and, therefore, the employers of said employees are not required to participate in the federal-state unemployment compensation tax program.

This Court then vacated the District Court's judgment and remanded the case on the basis that 28 United States Code section 1341 barred this action by the religious schools in which they were seeking exemption from unemployment taxes on religious grounds. The court reasoned that the religious schools had a plain, speedy and efficient remedy in state court through the suit for refund procedures.

In the course of the *Grace Brethren* decision, this Court noted several important points:

> (1) That a state court remedy is plain, speedy and efficient if it provides the taxpayer with a full hearing and judicial determination at which he may raise any and all constitutional objections to the tax. (..... U.S. ....., 73 L.Ed.2d 108.)
>
> (2) That Congress and the federal courts have both expressed in their own way the long-established policy of not interfering with the operation of state tax systems if the taxpayer had an available remedy in the state courts. (..... U.S. ....., 73 L.Ed.2d 109.)
>
> (3) That the California Unemployment Insurance Code provides a plain, speedy and efficient remedy to the taxpayer. (..... U.S. ....., 73 L.Ed.2d 110-112.)

In this case, the Court of Appeal held that Capitol has speedy, efficient and proper remedies before the state administrative and judicial machinery, and that its proper, speedy and efficient remedy is to have Capitol pay the tax, if any is ultimately assessed,[8] and then pursue an action in the state courts.

The California Revenue and Taxation Code provisions referred to below provide readily available and wholly effective administrative procedures for aggrieved taxpayers. Once these administrative remedies have been exhausted, the taxpayer can institute an action for a refund in the state court. This procedure has been consistently held, as a matter of law and without a single instance of deviation, to be plain, speedy and efficient as to invoke the restraints of

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[8]Because Capitol has not yet exhausted its administrative remedies, the entire lawsuit may become moot if Capitol prevails at the administrative level.

28 United States Code section 1341. (*Nevada-California Electric Corp. v. Corbett, supra,* 22 F.Supp. 951; *Corbett v. Printers and Publishers Corp., Ltd., supra,* 127 F.2d 195, 197.) Moreover, a taxpayer can further expedite the state administrative procedures by paying the tax, filing a claim for refund and wait for six months, and then filing a suit for refund in the state court. (Rev. & Tax. Code, §§ 26073, 26074, 26075 and 26076.) Since Capitol has not exhausted its available state administrative and judicial remedies, the action should be dismissed for lack of jurisdiction. (*Bland v. McHann, supra,* 463 F.2d 21, cert. den., 410 U.S. 966.)

Finally, in its misguided effort to support an untenable position, Capitol has been forced to rely on a group of cases which are completely inapposite. For example, *Hillsborough v. Cromwell* (1946) 326 U.S. 620, involved a New Jersey statute where the taxpayer's state remedies were not certain. In fact the taxpayer's right of review of constitutional questions by the New Jersey judiciary was dependent on the discretionary grant of certiorari by the New Jersey Supreme Court. Capitol certainly cannot be contending that California provides only discretionary judicial review. If it is so contending, it is absolutely wrong because all taxpayers have the absolute right of judicial review of all issues by way of a suit for refund. The California and federal courts have consistently held that the suit for refund procedure furnishes the taxpayer with a plain, speedy and efficient remedy. (*Aronoff v. Franchise Tax Board* (1965) 348 F.2d 9; *Greene v. Franchise Tax Board* (1972) 27 Cal.App.3d 38; *Casey v. Bonelli* (1949) 93 Cal.App.2d 253; and *Modern Barber Col., Inc. v. California Emp. Stab. Com.* (1948) 31 Cal.2d 720.)

Then Capitol goes on to completely mischaracterize the holding of *West Publishing Co. v. McColgan* (1946) 27 Cal.

2d 705, affirmed, 328 U.S. 823. In *West Publishing*, the court was not called upon to decide the question of whether the taxpayer could present before the trial court evidence which it had not previously presented to the administrative agency. *In fact, the plaintiff in West Publishing had flatly refused to file a tax return.* It is difficult to believe that Capitol would rely so heavily on *West Publishing* and then twist its fact in a futile effort to draw a parallel with the facts in this case. Moreover, Capitol is well aware of the fact that in California all tax refund cases are tried de novo,[6] where the plaintiff is not limited to introducing before the court only such evidence as was previously presented to the administrative agency.

Then in what is clearly a desperate effort to gain this Court's attention, Capitol has misstated the facts and holding of the case of *Barnes v. State Board of Equalization* (1981) 118 Cal.App.3d 994. *Barnes* clearly and simply held that if a person willfully refuses to present any facts or data to the administrative agency to support his claim for refund, he cannot file a suit for refund because he has failed to exhaust his administrative remedies.[7] Any person

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[6]Capitol Records was a plaintiff in a sales tax refund case in California entitled *Capitol Records, Inc. v. State Board of Equalization*, Sacramento Superior Court No. 255286, where it engaged in extensive pretrial discovery proceedings.

[7]The facts set forth in the *Barnes* decision will show that *Barnes* was not a taxpayer; he was not registered with the State Board of Equalization; and he had never paid any taxes to the State Board of Equalization. Thus, when Barnes filed a claim for refund raising both factual and legal issues, the Board requested Barnes to provide support for his contentions. Barnes refused to furnish any support. As a result the Board denied the claim for refund. Barnes then filed a suit for refund although he had refused to supply the Board with any information, including the exact amounts and dates of alleged payment of taxes.

who reads *Barnes* would readily see that any attempt to analogize *Barnes* with this case is utterly meritless. Thus, petitioner's extensive speculation and conjecture as to what the California courts at all levels might do on account of *Barnes* is so absurd that comment is not necessary.

B. The Eleventh Amendment to the United States Constitution Deprives this Court of Jurisdiction in this Action and Mandates a Dismissal

Unchanged since its adoption in 1798, the Eleventh Amendment to the United States Constitution provides as follows:

> "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commercial or prosecuted against one of the United States by citizens of another State, or citizens or subjects of any foreign State."

The United States Supreme Court has consistently held that an unconsenting state is immune from suits brought in federal court by her own citizens as well as by citizens of another state. (*Hans v. Louisiana* (1890) 134 U.S. 1; *Duhane v. New Jersey* (1920) 251 U.S. 311; *Great Northern Life Insurance Co. v. Read* (1944) 322 U.S. 47; *Parden v. Terminal R. Co.* (1964) 377 U.S. 184; *Employees v. Dept. of Public Health and Welfare* (1973) 411 U.S. 279.) It is also well established that even though a state is not named a party to the action, the suit may nonetheless be barred by the Eleventh Amendment. In *Ford Motor Co. v. Dept. of Treasury* (1945) 323 U.S. 459, the Supreme Court said:

> "[W]hen the action is in essence one for the recovery of money from the state, the state is the real, substantial party in interest and is entitled to invoke its sovereign immunity from suit even though individuals are nominal defendants." (*Id.* at p. 464.)

Thus, the rule has evolved that a suit by private parties seeking to impose a liability which ultimately will be paid from public funds in the state treasury is barred by the Eleventh Amendment. (*Great Northern Life Insurance Co. v. Read, supra*; *Kennecott Copper Corp. v. Tax Comm'n* (1946) 327 U.S. 573.)

As Capitol alleges in its complaint, the defendants are members of the California FTB and its chief executive officer. And as Capitol further alleges in its complaint, defendants were merely carrying out their statutory duties as members of the FTB or as its chief executive officer. In such an action, while the individuals may be named as nominal defendants, the treasury of the State of California will to a virtual certainty be deprived of revenue which otherwise would normally have been collected. Absent a waiver by the State of California, the Eleventh Amendment is, therefore, a bar to Capitol's action.

In deciding whether a state has waived its constitutional protection under the Eleventh Amendment, the United States Supreme Court has held that a waiver will be found only where stated "by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction." (*Murray v. Wilson Distilling Co.* (1909) 213 U.S. 151, 171.) As stated in the court's decision in *Edelman v. Jordan* (1973) 415 U.S. 651, 673:

> "We see no reason to retreat from the Court's statement in *Great Northern Life Insurance Co. v. Read*, 322 U.S. at 54 (footnote omitted): '[W]hen we are dealing with the sovereign exemption from judicial interference in the vital field of financial administration a clear declaration of the state's intention to sub-

> mit its fiscal problems to other courts than those of its own creation must be found.'"

To the extent that the State of California administers the Bank and Corporation Tax Law (Rev. & Tax. Code, § 23001 et seq.), it clearly has not waived such immunity. To the contrary, the state has established in state courts a "plain, speedy, and efficient remedy" for determining whether taxes have been erroneously or illegally assessed or collected (Rev. & Tax. Code, § 25661 et seq.; § 26071 et seq.; § 26102; *Corbett v. Printers and Publishers Corp., Ltd., supra,* 127 F.2d 195, 197; *Nevada-California Electric Corp. v. Corbett, supra,* 22 F.Supp. 951). Capitol has, therefore, failed to meet its burden of alleging or showing that the State of California has waived its immunity from this kind of suit, or this particular suit, in federal court. (*Whitner v. Davis* (9th Cir. 1969) 410 F.2d 24, 29; *Clark v. State of Washington* (9th Cir. 1966) 366 F.2d 678, 680.)

In *Fair Assessment In Real Estate Association, Inc. v. McNary, supra,* ..... U.S. ....., 70 L.Ed.2d 271, this Court again recognized the prohibitions of the Eleventh Amendment with respect to state fiscal matters notwithstanding *Ex Parte Young* (1908) 209 U.S. 123.

> "After this Court conclusively decided that federal courts *may* enjoin state officers from enforcing an unconstitutional state law, *Ex Parte Young,* 209 U.S. 123 (1908), Congress also recognized that the autonomy and fiscal stability of the States survive best when state tax systems are not subject to scrutiny in federal courts. Thus, in 1937 Congress provided: [Text of 28 U.S.C. § 1341]." (*Fair Assessment In Real Estate Association, Inc. v. McNary, supra,* ..... U.S. ....., 70 L.Ed. 2d 271.)

II

NO INJUNCTION MAY ISSUE NOR DECLARATORY RELIEF BE GRANTED TO PREVENT OR ENJOIN THE ASSESSMENT OR COLLECTION OF TAXES

Capitol has correctly alleged in its complaint that under California law a suit for injunction, declaratory relief or other equitable process to prevent or enjoin the assessment or collection of any taxes is forbidden.

Section 32 of article XIII of the California Constitution states:

> "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid with interest, in such manner as may be provided by the Legislature."

In like manner, Revenue and Taxation Code section 26101 relating specifically to the assessment or collection of bank and corporation taxes states:

> "No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding in any court against this State or against any officer of this State to prevent or enjoin the assessment or collection of any tax under this part."

These provisions have been continually sustained by the courts. (*Pacific Gas & Electric Co. v. St. Bd. of Equalization* (1980) 27 Cal.3d 277; *Aronoff v. Franchise Tax Board, supra,* 348 F.2d 9; *Casey v. Bonelli, supra,* 93 Cal.App.2d 253; *Modern Barber Col. Inc. v. California Emp. Stab. Com., supra,* 31 Cal.2d 720.) But Capitol's allegation does not confer federal court jurisdiction. If Capitol would pay

the tax and litigate the question in the state courts just like the rest of the California taxpayers, Capitol would not have the problem with which it is faced. Equal protection and due process do not mean preferential treatment for wealthy corporations with unlimited resources to pay for protracted but clearly untenable litigation.

III

CALIFORNIA COURTS CAN AND ARE FULLY QUALIFIED TO DECIDE THE QUESTION OF THE CONSTITUTIONALITY OF THE UNITARY METHOD OF TAXATION AS APPLIED TO CAPITOL

Even in this age of profligate lawsuits, this action by Capitol is as incredible as the one brought by EMI, Limited, Capitol's parent. This is not an action involving any basic inalienable constitutional rights of a resident or citizen of the United States. Quite to the contrary. This is an action by a wealthy corporation, brought in violation of long-established law in an effort to sidestep the state court and to use the federal courts to judicially overthrow the sovereign taxation powers of the State of California.

If California's unitary method is as unconstitutional and illegal as Capitol would have this Court believe, the California appellate and supreme courts would nullify it. After all, Capitol has not furnished any evidence that the California courts are not capable of understanding the law. Nor is there any evidence that the California courts would not follow the laws as interpreted by the United States Supreme Court.

Capitol's suit is also disruptive of the entire judicial process. There are recognized principles covering the subject of contesting state taxes. In addition, there is the proscrip-

tion against multiple lawsuits. In this day when the public is clamoring for less taxes and greater government efficiency, responsible persons should seek to minimize litigation. This lawsuit completely violates these principles. There is not one valid reason for a taxpayer such as Capitol to challenge a state tax in the federal courts when it has an adequate and speedy remedy before the California administrative agencies and courts. (*Aronoff v. Franchise Tax Board, supra,* 348 F.2d 9.) Moreover, there will be utter chaos if every disgruntled taxpayer sought to attack state laws in the federal courts under the guise of some purported violation of a constitutional provision.

CONCLUSION

For the foregoing reasons, it is respectfully submitted this petition for writ of certiorari should be denied.

Respectfully submitted,

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